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ACTION SS-15

INFO OCT-01 NEA-10 ISO-00 IO-13 SP-02 USIA-06 AID-05 EB-07

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C O N F I D E N T I A L CAIRO 13187

EO 11652: GDS

TAGS: EGEN, EAID, EG

SUBJ: EGYPTIAN REQUIREMENTS FOR BALANCE OF PAYMENTS AID

REF STATE 236771,

1. ON LARGE ASSUMPTION GOE WILL ADOPT MAJOR ELEMENTS OF IMF REFORM PROGRAM BY END OF 76, WE FORESEE AS RESULT ONLY MARGINAL RISE IN EXPORTS BUT POSSIBLY SIGNIFICANT DECLINE IN IMPORTS (SEE FOLLOWING PARAS). ESSENTIALLY UNRELATED FACTORS WILL CAUSE FURTHER INCREASE IN EXPORT EARNINGS AND NET SERVICES ITEM. PRIVATE UNREQUITED TRANSFERS, TOO, CAN BE EXPECTED TO CONTINUE UPWARD TREND THROUGH 1977-79 PERIOD, ALTHOUGH PROBABLY AT RATE OF INCREASE LOWER THAN IN PAST THREE YEARS. ONE IMPORTANT QUESTION ON CURRENT ACCOUNT BALANCE OVER NEAR TERM WILL BE SIZE OF GOVT TRANSFERS, GIVEN VIRTUAL CERTAINTY MERCHANDISE TRADE GAP, WHILE DIMINISHED, WILL REMAIN LARGE THROUGH 1979.

2. TO ASSESS POTENTIAL IMPACT SPECIFICALLY ON IMPORTS OF ADOPTION IMF REFORMS, IT IS NECESSARY TO CONSIDER SEPARATELY CURRENT IMPORTS OF CONSUMER DURABLES (LARGELY THROUGH OWN
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EXCHANGE MARKET) PUBLIC ENTERPRISE IMPORTS (THROUGH PARALLEL

AND OFFICIAL MARKETS), AND CENTRAL GOVT IMPORTS OF BASIC SUPPLY COMMODITIES AT OFFICIAL RATE. ASSUMING NEW UNIFIED RATE IS SET FOR EXISTING OWN EXCHANGE AND PARALLEL RATES, EFFECT OF NEW RATE BY ITSELF ON IMPORTS CURRENTLY PASSING THROUGH OWN PARALLEL MARKETS UNLIKELY TO BE SUBSTANTIAL. IN COMBINATION WITH APPROPRIATE TARIFF AND TAX POLICIES ON LUXURY AND SEMI-LUXURY COMMODITIES, HOWEVER, IMPACT COULD BE APPRECIABLE IN SHORT-TERM.

3. SHIFTING OF VIRTUALLY ALL PUBLIC ENTERPRISE IMPORTS TO NEW RATE PROBABLY WOULD HAVE APPRECIABLE IMPACT ON LEVEL OF IMPORTS - PARTICULARLY IF GOE FOLLOWS OTHER IMF AND IBRD RECOMMENDATIONS TO FOCUS INVESTMENT PRIORITIES ON PROJECTS THAT ARE LESS INTENSIVE USERS OF FOREIGN EXCHANGE THAN IS CURRENT CASE, AND IF GREATER EFFORT IS MADE TO LINK PUBLIC SECTOR INVESTMENT APPROVAL AND IMPLEMENTATION TO AVAILABLE CONCESSIONAL FOREIGN FINANCING. IMPORTS OF BASIC SUPPLY COMMODITIES ARE ADMINISTRATIVELY DETERMINED AND WOULD NOT BE EXPECTED TO BE DIRECTLY AFFECTED BY FOREIGN EXCHANGE REFORM. HOWEVER, IMF PROPOSALS FOR REDUCTION OF PRICE SUBSIDIES FOR DOMESTIC MARKET MAY LEAD TO REDUCTION OF WHEAT IMPORTS AND/OR INCREASED COTTON EXPORTS.

4. WE ARE ABLE TO CITE A POST 73 TREND IN THIRD COUNTRY AID TO EGYPT ONLY WITH RESPECT TO US ASSISTANCE AND RELATIVELY SMALL WESTERN EUROPEAN/JAPANESE PROJECT LOANS AND SUPPLIERS CREDITS. ARAB AID, WHICH IS OF COURSE CRUCIAL TO EGYPTIAN BOP SITUATION, HAS BEEN UNFICIENT THROUGH THIS YEAR (\$750 MILLION IN CASH AID, PLUS \$500 MILLION GODE GUARANTEE AND LOAN UNDER NEGOTIATION). ARAB NONPROJECT AID OTHER THAN UNDER RABAT AND KHARTOUM AGREEMENTS, HOWEVER, WAS EXTENDED THROUGH MID-76 ON AD HOC BILATERAL BASIS TO BAIL OUT ECONOMY. FUTURE OF THIS HERETOFORE ABSOLUTELY ESSENTIAL FORM OF CASH ASSISTANCE NOW SEEMS LINKED NOT ONLY WITH IMPLEMENTATION OF IMF REFORMS, BUT ALSO IMPORTANTLY WITH STRUCTURE AND GOALS OF GODE CONDUIT. BILATERAL ARAB ASSISTANCE CAN REASONABLY BE EXPECTED TO PLAY MUCH LESS SIGNIFICANT ROLE IN MEETING EGYPT'S BOP DEFICITS OVER NEXT THREE YEARS. EXCEPTIONAL CASE OF LARGE ONE-TIME SAUDI/KUWAITI TRANSFER CONTINGENT UPON GOE ACCEPTANCE OF IMF RECOMMENDATIONS AND OUTSIDE

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GODE FRAMEWORK IS CONCEIVABLE, BUT LIKELY WOULD INVOLVE EXCEPTIONAL APPROACHES TO JIDDA BY BOTH GOE AND USG.

5. IN ABSENCE OF INFO ON EXACT PROVISIONS OF IMF PACKAGE WHICH WILL PROVE TO BE ACCEPTABLE TO GOE, AND LACKING FIRM DATE ON AREAS OF FOREIGN TRADE SECTOR TO BE AFFECTED THEREBY, WE ARE LEFT WITH ONLY VERY ROUGH IDEA OF SIZE EGYPTIAN REQUIREMENTS FOR CASH BOP ASSISTANCE 1977-79. IT

APPEARS TO US THERE ARE TOO MANY VARIABLES EVEN IN PURELY ECONOMIC TERMS TO PRDUCT WITH MUCH CONFIDENCE WHAT WILL BE QUANTITATIVELY INDENTIFIABLE RESULTS OF NOT-YET-ENACTED REFORM PROGRAM. IF GOE OPTS FOR TOKENISM OR HALF-WAY MEASURES, BASICALLY FOR POLITICAL REASONS, THEN BOP CASH ASSISTANCE REQUIREMENTS WILL BE ONLY marginally REDUCED FROM 1976 LEVEL OF ABOUT \$2.3 BILLION. IF ON OTHER HAND DECISION IS TAKEN ACTUALLY TO ADOPT STRINGENT MESURES NEEDED FOR FUNDAMENTAL RE-ORIENTATION OF PRESENTLY SKEWED ECONOMY, I.E., RATIONALIZING EXCHANGE RATE, ELIMINATING SUBSIDIES AND ADOPTING EFFECTIVE FINANCIAL MANAGEMENT MEASURES INCLUDING REVISED TARIFF/TAXATION POLICIES, PROSPECTS ARE REASONABLY GOOD FOR REDUCTION OF CASH BOP AID REQUIREMENTS TO MANAGEABLE LEVEL BY END OF 1979.

6. WHICH COURSE OF ACTION GOE SETS OUT TO FOLLOW DEPENDS ON ITS POST-ELECTION PERCEPTION OF POLITICAL-ECONOMIC IMPERATIVES. OUR PRESENT READING OF SITUATION DOES NOT LEAD US TO BE OPTIMISTIC REGARDING LIKELIHOOD OF GOE PURSUING FULL AND EFFECTIVE REFORM PROGRAM. BASIC QUESTION THAT NEEDS TO BE ADDRESSED IS WHAT WOULD ACTUALLY HAPPEN OF GOE INDEED FAILS TO ADOPT EFFECTIVE REFORM PROGRAM AND AVAILABLE BOP FINANCING IS INADEQUATE TO COVER CONTINUING LARGE DEFICITS OF WHATEVER SIZE. SINCE FAILURE TO ENACT REFORMS WILL LEAD TO CONTINUING LARGE BOP DEFICTS (IF FINANCING IS AVAILABLE), OR HIGHLY RESTRICTIVE AND PROBABLY DISRUPTIVE IMPORT CONTROL MEASURES (IF MASSIVE CONTINUING FINANCING IS NOT AVAILABLE), IMPORTANCE OF ENCOURAGING GOE TO ADOPT REFORMS IS OBVIOUS. IN THIS REGARD, HOWEVER, BELIEVE GREATER EFFORT NEEDS TO BE MADE TO ANALYZE POTENTIAL SOCIAL/ POLITICAL IMPACT OF REFORM PROGRAM. IF GOE'S PRIMARY POLITICAL CONCERN IS WITH ADVERSE INCOME DISTRIBUTION IMPACT OF REFORM PACKAGE, THEN IMF/IBRD SHOULD BE PREPARED TO

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ASSESS (1) WHAT THIS IMPACT REALLY WILL BE, AND (2) HOW THE REFORM PROGRAM CAN BE STRUCTURED SO AS TO REDUCE THIS IMPACT TO AN ACCEPTABLY MINIMUM. WE ARE AWARE OF NO SUCH STUDIES THUS FAR OF THIS ASPECT OF THE PROBLEM.

MATTHEWS

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